

State of Idaho

Legislative Services Office

Individual Entity Audit Report

A communication to the Joint Finance-Appropriations Committee

IDAHO DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND

FY 2007

**Report OP24607
Date Issued: January 22, 2008**

Serving Idaho's Citizen Legislature

FOREWORD

PURPOSE OF AUDIT REPORT

Our fiscal/compliance audit of the Idaho Department of Environmental Quality, Drinking Water State Revolving Fund was made to determine:

1. The adequacy and accuracy of the fiscal records and the reliability of the internal control system in order to issue an opinion on the fairness of the Fund's financial statements.
2. The degree of compliance with various State laws, rules, and regulations affecting the fiscal operations of the Fund.
3. The areas in the financial operations that could be improved.

SCOPE OF AUDIT

We examined the financial operations of the Fund for the fiscal year ended June 30, 2007.

The audit was performed in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards* published by the U.S. Government Accountability Office (GAO).

Information contained in this report was gathered from accounting and administrative records. We also interviewed Department personnel.

AUDIT AUTHORIZATION

Reported to the Joint Finance-Appropriations Committee as directed by the Legislative Council of the Idaho Legislature, authorized by Idaho Code, Section 67-429.

ASSIGNED STAFF

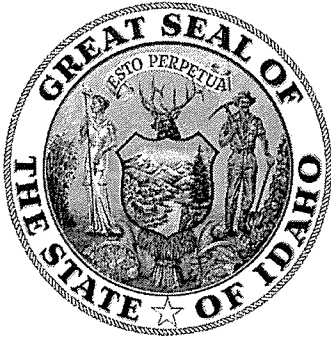
J.E. Bowden, CPA, Auditor-in-Charge
Eric Bjork, Staff Auditor

ADMINISTRATION AND TECHNICAL REVIEW

Don H. Berg, CGFM, Manager, Legislative Audits Division
Chris Farnsworth, CPA, Managing Auditor

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EXECUTIVE SUMMARY LEGISLATIVE AUDITS

IDAHO DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND

PURPOSE AND SCOPE. We have audited the financial statements of the Idaho Department of Environmental Quality, Drinking Water State Revolving Fund (DWSRF) for the fiscal year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America. The purpose of our audit is to determine whether the DWSRF's financial statements are materially accurate and reliable, and that the Department complied with laws and regulations affecting fiscal operations. The U.S. Environmental Protection Agency (EPA) requires a separate annual financial and compliance audit of the DWSRF.

CONCLUSION. We conclude that the DWSRF's financial statements are materially accurate and reliable, and fiscal operations materially comply with related laws and regulations. As a result, we issued an unqualified opinion on the DWSRF's financial statements.

FINDINGS AND RECOMMENDATIONS. There are no findings and recommendations in this report or in the prior report.

AGENCY RESPONSE. The Department has reviewed the report and is in general agreement with its contents.

FINANCIAL SUMMARY. The DWSRF is financed by grants from the EPA and State matching funds. The DWSRF is used to provide loans to municipalities at reduced rates to finance construction of publicly owned drinking water facilities. The financial activity of the DWSRF for the fiscal year ended June 30, 2007 is summarized as follows:

DRINKING WATER STATE REVOLVING FUND - STATEMENT OF NET ASSETS AT JUNE 30, 2007

ASSETS:	
<u>Current Assets</u>	
Cash	\$4,961,741
Investments	4,367,162
Loans Receivable	1,290,652
Interest Receivable	206,999
Due from Other Entities	<u>1,364,505</u>
Total Current Assets	\$12,191,059
<u>Non-Current Assets</u>	
Loans Receivable	43,186,234
Loan Interest Receivable	<u>439,667</u>
Total Non-Current Assets	<u>\$43,625,901</u>
TOTAL ASSETS	<u>\$55,816,960</u>
LIABILITIES:	
<u>Current Liabilities</u>	
Miscellaneous Payables	<u>\$114,432</u>
TOTAL LIABILITIES	<u>\$114,432</u>
NET ASSETS:	
Unrestricted	<u>\$55,702,528</u>
TOTAL NET ASSETS	<u>\$55,702,528</u>

DRINKING WATER STATE REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2007

<u>Operating Revenues</u>	
Interest Earned – Loans	\$1,110,336
EPA Operating Revenues	<u>2,065,808</u>
Total Operating Revenues	<u>\$3,176,144</u>
<u>Operating Expenses</u>	
Program Administration	\$301,915
Program Set-Aside Other Expenses	<u>1,763,893</u>
Total Operating Expenses	<u>\$2,065,808</u>
Operating Income	\$1,110,336
<u>Non-Operating Revenues</u>	
<u>Capital Contributions</u>	
Contributions from EPA	9,226,338
Contributions from State	2,257,945
Interest Earned – Fund Balance	<u>344,462</u>
Total Non-Operating Revenue	<u>\$11,828,745</u>
Changes in Net Assets	\$12,939,081
Net Assets – Beginning of Year (Restated)	<u>42,763,447</u>
Net Assets – End of Year	<u><u>\$55,702,528</u></u>

OTHER ISSUES. We discussed other matters with the Department which, if addressed, would improve internal control, compliance, and efficiency over the DWSRF.

This report is intended solely for the information and use of the Idaho Department of Environmental Quality, the U.S. Environmental Protection Agency, and the Idaho Legislature and is not intended to be used by anyone other than these specified parties.

We appreciate the cooperation and assistance provided to us by the director, Toni Hardesty, and her staff.

QUESTIONS CONCERNING THIS AUDIT SHOULD BE DIRECTED TO:

Don H. Berg, CGFM, Manager, Legislative Audits Division

Chris Farnsworth, CPA, Managing Auditor

Report OP24607

AGENCY RESPONSE



STATE OF IDAHO
DEPARTMENT OF
ENVIRONMENTAL QUALITY

1410 North Hilton • Boise, Idaho 83706 • (208) 373-0502

C.L. "Butch" Otter, Governor
Toni Hardesty, Director

December 14, 2007

Mr. Don Berg, CGFM, Division Manager
Legislative Audits
954 West Jefferson
Boise, Idaho 83720

Re: Audit Report – 2007 Drinking Water Revolving Fund

Dear Mr. Berg:

The Department of Environmental Quality accepts the audit report. We appreciate the hard work of J. E. Bowden and Eric Bjork of your audit staff.

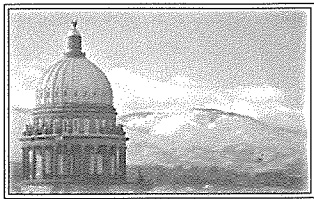
If you or your staff have any further questions, please contact Dave Sande, CPA, Financial Officer.

Sincerely,

A handwritten signature in dark ink, appearing to read "Toni", followed by a long, horizontal, wavy line.

Toni Hardesty
Director

cc: Dave Sande, DEQ-Fiscal Office



Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz
Director

December 14, 2007

Unqualified Opinion on
Basic Financial Statements

Independent Auditor's Report

Toni Hardesty, Director
Idaho Department of Environmental Quality
1410 North Hilton Street
Boise, ID 83706

Dear Ms. Hardesty:

We have audited the accompanying financial statements of the governmental activities and the special revenue fund of the Idaho Drinking Water State Revolving Fund (DWSRF) as of and for the year ended June 30, 2007, which collectively comprise the DWSRF's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the DWSRF's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the DWSRF as of June 30, 2007, and the respective changes in financial position and its cash flow for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2007, on our consideration of the DWSRF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered when assessing the results of our audit.

Mike Nugent, Manager
Research & Legislation

Cathy Holland-Smith, Manager
Budget & Policy Analysis

Don H. Berg, Manager
Legislative Audits

Glenn Harris, Manager
Information Technology

The Management Discussion and Analysis on pages 7 and 8 is not a required part of the basic financial statements, but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion thereon.

Sincerely,

A handwritten signature in black ink, appearing to read "Don H. Berg", with a stylized flourish extending from the end.

Don H. Berg, CGFM, Manager
Legislative Audits Division

MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2007

This section of the Idaho Drinking Water State Revolving Fund's (DWSRF) annual audit report presents the Department of Environmental Quality's (DEQ) evaluation of the financial performance of the program for the State fiscal year 2007 (July 1, 2006 through June 30, 2007).

OVERVIEW OF FINANCIAL STATEMENTS

The DWSRF's basic financial statements include the Enterprise Fund financial statements and accompanying notes to the financial statements. The Enterprise Fund financial statements consist of the following required elements necessary for fair presentation:

- Statement of Net Assets – This statement presents information on all assets and liabilities of the DWSRF, with the difference between assets and liabilities reported as net assets.
- Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents all revenues, expenses, and changes in net assets of the DWSRF. The information in this statement is segregated into operating revenues, operating expenses, and non-operating revenues.
- Statement of Cash Flows – This statement details the categorical sources and uses of cash within the DWSRF, and provides a reconciliation of income to net cash provided by operating activities.
- Notes to the Financial Statements – This section details the financial activities, accounting policies and practices, as well as specific account information for the DWSRF.

These financial statements provide additional information to the specific operations of the DWSRF than that presented in the State of Idaho fiscal year 2007 *Comprehensive Annual Financial Report (CAFR)*. The Idaho *CAFR* includes the DWSRF; the related but separate Clean Water State Revolving Loan Fund (CWSRF), which is also operated by the Idaho DEQ; and the Idaho Department of Water Resources' loan program. Taken together, these three programs make up the Loan Fund as reported in the *CAFR*.

FINANCIAL HIGHLIGHTS FOR FISCAL YEAR 2007

- The DWSRF made \$12.2 million in loan disbursements to Idaho communities for drinking water projects. The money used for these disbursements was from two primary sources: \$9.2 million from the U.S. Environmental Protection Agency (EPA) DWSRF capitalization grants and \$2.7 million from State matching funds, and \$11.8 million from revolving funds (collected loan repayments and related revenues).
- Loan repayments of \$3.2 million were received, with all loans being current. Historically, the DWSRF has not experienced any loan defaults.
- Investments made by the Office of the Idaho State Treasurer earned \$134,000 in interest on DWSRF cash deposits remaining in the Idle Pool, and \$210,000 was earned by the Diversified Bond Fund.

CONDENSED FINANCIAL INFORMATION

	FY 2007	<u>FY 2006</u> (as restated)
<u>NET ASSETS</u>		
Total Assets	\$55,794,070	\$42,818,900
Total Liabilities	<u>114,432</u>	<u>55,453</u>
Total Net Assets	<u>\$55,679,638</u>	<u>\$42,763,447</u>
<u>CHANGES IN NET ASSETS</u>		
Loan Interest Revenue	\$1,110,336	\$900,469
Operating Revenue	2,055,977	1,938,789
Non-Operating Revenue	<u>11,827,262</u>	<u>7,504,252</u>
Total Revenue	\$14,993,575	\$10,343,510
Operating Expenses	<u>2,065,808</u>	<u>1,918,177</u>
Change in Net Assets	<u>\$12,927,767</u>	<u>\$8,425,333</u>

ANALYSIS OF FINANCIAL POSITION

The Idaho DWSRF continued to show growth in fiscal year 2007, as evidenced by the \$13 million increase in total assets. This growth in assets was primarily due to the consumption of the federal capitalization grant and State matching funds. During fiscal year 2007, EPA grants contributed \$9.2 million toward loan disbursements, while Idaho matching funds contributed an additional \$2.7 million. The DWSRF earned \$1.1 million in loan interest revenue.

Loans receivable as of June 30, 2007, was \$44.5 million, an increase of \$10 million from the prior year. During the year, the DWSRF made loan disbursements of \$12.2 million, while collecting \$2.2 million in loan principal repayments.

Cash and investments increased \$3 million, for a balance of \$9.3 million. This was primarily the result of loan repayments of \$3.2 million.

There are no known facts, decisions, or conditions expected to have a significant effect on the DWSRF.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND
STATEMENT OF NET ASSETS
AS OF JUNE 30, 2007

ASSETS

Current Assets

	Loan Activities	Set-Aside Programs	Total
Cash	\$5,029,745	(\$68,004)	\$4,961,741
Investments	4,367,162	0	4,367,162
Interest Receivable - Fund Balance	36,334	0	36,334
Interest Receivable - Loans	170,665	0	170,665
Loans Receivable	1,290,652	0	1,290,652
Due From EPA	0	182,436	182,436
Due From State	1,182,069	0	1,182,069
Total Current Assets	\$12,076,627	\$114,432	\$12,191,059

Non-Current Assets

Loan Interest Receivable	\$439,667	\$0	\$439,667
Loans Receivable	43,186,234	0	43,186,234
Total Non-Current Assets	\$43,625,901	\$0	\$43,625,901
Total Assets	\$55,702,528	\$114,432	\$55,816,960

LIABILITIES

Current Liabilities

Set Asides Payable	\$0	\$104,744	\$104,744
Loan Administration Payable	0	9,688	9,688
Total Current Liabilities	\$0	\$114,432	\$114,432
TOTAL LIABILITIES	\$0	\$114,432	\$114,432

NET ASSETS

Unrestricted	\$55,702,528	\$0	\$55,702,528
TOTAL NET ASSETS	\$55,702,528	\$0	\$55,702,528

The accompanying notes are an integral part of these financial statements.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2007

	Loan Activities	Set-Aside Programs	Total
OPERATING REVENUES			
Interest Earned - Loans	\$1,110,336	\$0	\$1,110,336
EPA Operating Revenue	0	2,065,808	2,065,808
Total Operating Revenues	\$1,110,336	\$2,065,808	\$3,176,144
OPERATING EXPENSES			
<u>Program Administration</u>			
Personnel Expense	\$0	\$196,299	\$196,299
Operating Expense	0	39,918	39,918
Travel	0	3,085	3,085
Indirect	0	62,613	62,613
Total Program Administration	\$0	\$301,915	\$301,915
<u>Program Set-Asides</u>			
Personnel Expense	\$0	\$797,211	\$797,211
Operating Expense	0	697,671	697,671
Travel	0	14,664	14,664
Indirect	0	254,347	254,347
Total Program Set-Asides	\$0	\$1,763,893	\$1,763,893
Total Operating Expenses	\$0	\$2,065,808	\$2,065,808
Operating Income	\$1,110,336	\$0	\$1,110,336
NON-OPERATING REVENUES			
<u>Capital Contributions</u>			
Contributions From EPA	\$9,226,338	\$0	\$9,226,338
Contributions From State	2,257,945	0	2,257,945
Interest Earned-Fund Balance	344,462	0	344,462
Total Non-Operating Revenues	\$11,828,745	\$0	\$11,828,745
Change in Net Assets	\$12,939,081	\$0	\$12,939,081
Net Assets - Beginning of Year (Restated)	42,763,447	0	42,763,447
Net Assets - End of Year	\$55,702,528	\$0	\$55,702,528

The accompanying notes are an integral part of these financial statements.

**STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDING JUNE 30, 2007**

CASH FLOWS FROM OPERATING ACTIVITIES

Loans and Interest Cash Flows

Cash Received - Loan Interest Payments	\$956,171
Cash Received - Loan Principal Repayments	2,226,110
Loan Disbursements	(12,166,491)
Cash Received From EPA	1,941,233
Cash Disbursed - Administration Expenses	(300,057)
Cash Disbursed - Other Program Expenses	(1,706,772)
Net Cash Provided (Used) by Operating Activities	<u>(\$9,049,806)</u>

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Cash Received From EPA	\$9,226,338
Cash Received as State Match	2,674,301
Net Cash Provided(Used) by Non-Capital Financing Activities	<u>\$11,900,639</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of Investments	(\$211,077)
Cash Received - Investment Interest	331,631
Net Cash Provided(Used) by Investing Activities	<u>\$120,554</u>

Net Decrease in Cash	\$2,971,387
Cash Balance - Beginning of Year (Restated)	1,990,354
Cash Balance - End of Year	<u><u>\$4,961,741</u></u>

Reconciliation of Operating Income to Net Cash

Provided (Used) by Operating Activities

Operating Income	\$1,110,336
Adjustments to Reconcile Operating Income to Net Cash	
Used by Operating Activities	
Change in Interest Receivable - Loans	(154,165)
Change in Loans Receivable	(9,940,381)
Change in Due From EPA	(124,575)
Change in Administrative Payable	1,858
Change In Program Set-Asides Payable	57,121

Net Cash Provided(Used) by Operating Activities	<u><u>(\$9,049,806)</u></u>
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The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

NOTE #1

SIGNIFICANT ACCOUNTING POLICIES

Organization of the Fund

The Drinking Water State Revolving Fund (DWSRF) was established pursuant to Title VI of the Federal Water Quality Act of 1987 (the Act). The Act established the DWSRF program to replace the construction grants program and provide loans at reduced interest rates to finance the construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the DWSRF provides a flexible financing source that can be used for a variety of pollution control projects. Loans made by the DWSRF must be repaid within 20 years, and all repayments, including interest and principal, must be returned to the DWSRF. The money in the DWSRF is to be used for eligible purposes in perpetuity.

The DWSRF is in the process of being capitalized by the U.S. Environmental Protection Agency (EPA) through a series of grants beginning in 1989. States are required to provide an additional 20% of the federal capitalization grant as matching funds in order to receive a grant. As of June 30, 2007, Congress authorized the EPA to award \$85,163,500 in capitalization grants to Idaho. The State is required to contribute \$17,032,700 in matching funds. DWSRF loan repayments, including interest and principal, must be returned to the DWSRF. DWSRF money is used for eligible purposes in perpetuity. In accordance with the Act, the corpus of the federal and State capital contributions to the DWSRF will be maintained. All disbursements, repayments, contributions from federal and State sources, and related transactions are accounted for within the DWSRF.

The DWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The DWSRF does not have any full time employees. Instead, DEQ charges the DWSRF for time spent on DWSRF activities by DEQ employees, and the DWSRF reimburses the DEQ fund for such costs. The charges include the salaries and benefits of the employees, as well as indirect costs allocated to the DWSRF based on direct salary costs. Employees charging time to the DWSRF are covered by the benefits of the State. The DWSRF is also charged indirect costs of the State through the cost allocation plan for general State expenses.

The financial statements are intended to present the financial position and results of the operations of the DWSRF, a component of the State of Idaho. These statements are not intended to present the financial position or results of operations for the Idaho Department of Environmental Quality, of which the DWSRF is a part.

Basis of Accounting and Measurement Focus

Enterprise funds, in accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting* are required to apply applicable FASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: *Statements and Interpretations of Financial Accounting Standards Board (FASB)*; *Accounting Principles Board Opinions*; and *Account Research Bulletins of the Committee on Accounting Procedures*. In addition, an enterprise activity may apply all FASB statements and interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements. The DWSRF has elected not to follow FASB pronouncements issued after November 30, 1989.

The DWSRF presents its financial statements as an enterprise fund. Enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting. The State's central accounting system records transactions on a cash basis of accounting. The financial records of the DWSRF have been converted as necessary to the accrual basis. The accrual basis of accounting requires recording revenues when earned and expenses when incurred.

Operating and Non-Operating Revenue and Expenses

Operating and non-operating revenue and expenses are presented separately on the operating statement. Operating revenue and expenses result from transactions associated with loan disbursements, collections, and the usual activity of the DWSRF, for example, interest earned and administrative expenses. All other transactions are reported as non-operating revenue, such as contributions from the EPA and the State.

Cash and Cash Equivalents

Pursuant to Idaho Code, all cash of the DWSRF is deposited with the Office of the State Treasurer. The State Treasurer is responsible for the investment of the cash balances of the State.

In accordance with the Safe Drinking Water Act and Idaho Code, all cash of the DWSRF is perpetually appropriated for program purposes.

NOTE #2
CASH AND INVESTMENTS

Capital Assets

Capital assets are generally defined as land, land improvements, buildings, fixtures, equipment, and property under construction, and are recorded at cost. The DWSRF owns no land, land improvements, buildings, fixtures, or property under construction and has no plans to acquire any.

Loans Receivable and Interest Capitalization

Loan funds are disbursed to the local agencies as the agencies incur costs for the purposes of the loan and request loan disbursements from the DWSRF. Typically, interest is calculated from the date that funds are advanced. After final disbursement has been made, the repayment schedule identified in the loan agreement is adjusted for the actual amounts disbursed and interest accrued during the project period. At the loan closing, the loan recipient is given the opportunity to payoff any accrued interest during the construction phase or to capitalize the interest into the loan principal, subject to the available debt capacity of the loan recipient as stated in the loan award.

Management considers all loans to be fully collectible; therefore, no allowance for uncollectible accounts is made.

Indirect Costs – Specific DWSRF Liabilities

Certain liabilities, such as compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases are obligations of the DEQ and the DWSRF receives an allocation of these costs, either through direct expenses as incurred or through the application of a negotiated indirect rate.

For the year ended June 30, 2007, the DWSRF did not have separate specific liabilities for compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases.

State Match

Under Idaho Code, the State match is perpetually appropriated from the Water Pollution Control Account. The State is only required to deposit a cash match into the DWSRF when an actual cash draw from the EPA is made.

The DWSRF participates in the State Treasurer's internal and external investment pools.

The Idle Fund is an internal investment pool managed by the State Treasurer's Office on behalf of participants. Money not needed to meet immediate operating obligations is invested in accordance with Idaho Code, Sections 67-1210 and 67-1210A. Participation in the pool is involuntary.

Idle Pool Credit Risk

State law limits investments to those listed in the Idaho Code sections identified above. The Treasurer has an informal investment policy to comply with State law, thus limiting credit risk.

The Treasurer's Idle Fund is an unrated internal investment pool. The DWSRF has total deposits of \$5,029,745 in the pool. Deposits are stated at cost, which approximates market.

Idle Pool Interest Rate Risk

The Treasurer has an informal investment policy that limits certain investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates.

The DWSRF also participates in the Diversified Bond Fund, an external investment pool sponsored by the State Treasurer's Office. A copy of the Idaho *Comprehensive Annual Financial Report (CAFR)*, including the investment pool's financial statement, is available from the Office of the State Controller, Bureau of Reporting and Review.

Idaho Code restricts the State Treasurer to certain types of investments.

Diversified Bond Fund Credit Risk

The State Treasurer's Diversified Bond Fund (DBF) has been assigned a AAA fund credit quality rating and an S2 volatility rating by Standard and Poor's Ratings Service.

The AAA rating of the DBF signifies that according to analysis conducted by Standard and Poor's, the portfolio holdings provide extremely strong protection against losses from credit defaults.

The S2 volatility rating assigned to the DBF indicates the Fund's low to moderate sensitivity to changing market conditions.

Diversified Bond Fund Interest Rate Risk

As of June 30, 2007, the DWSRF investment in the Diversified Bond Fund had a fair value of \$4,367,162 with a weighted average maturity of 3.5 years (from 2006). The State Treasurer has an informal investment policy that limits certain investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates.

Extent, Nature, and Terms of Financial Instruments

The DWSRF makes loans to qualified agencies for projects that meet the eligibility requirements of the Act. Loans are financed by capitalization grants, State match, and revolving funds. Effective interest rates on loans vary between 0% and 4%, and

NOTE #3

LOANS RECEIVABLE

are generally repaid over 20 years starting within one year after project completion.

Collateral

At the loan closing, the State receives collateral, typically a local revenue bond, local improvement district bond or promissory note, from the borrower. As of June 30, 2007, the Office of the State Treasurer held \$17,300,818 (at original face value) of bonds and \$7,187,576 (at original face value) of promissory notes as collateral for the DWSRF.

Loans by Category

Loans receivable at June 30, 2007, are as follows:

	<i>Loan Authorized</i>	<i>Principal Repayments</i>	<i>Remaining Commitment</i>	<i>Receivable Balance</i>
Completed Projects	\$32,033,440	\$5,769,906	\$0	\$26,263,534
Projects in Progress	<u>45,381,405</u>	<u>0</u>	<u>27,168,053</u>	<u>18,213,352</u>
Totals	<u>\$77,414,845</u>	<u>\$5,769,906</u>	<u>\$27,168,053</u>	\$44,476,886
Less: Amount Due Within 1 Year (Current)				<u>1,290,652</u>
Loans Receivable, Net of Current Maturities				<u>\$43,186,234</u>

The projected principal repayments in subsequent years are as follows:

<i>Year Ending June 30:</i>	<i>Amount</i>
2008	\$1,290,652
2009	1,731,988
2010	1,875,996
2011	1,964,745
2012	2,020,397
Thereafter	<u>35,593,108</u>
Total Loans Receivable	<u>\$44,476,886</u>

Major Loans

As of June 30, 2007, the DWSRF had made loans to the agencies listed below that, in aggregate by agency, exceeded \$3 million. The outstanding balance of these loans represents approximately 62% of the total loan receivable, as follows:

<i>Local Agency</i>	<i>Current Loan Amount</i>	<i>Outstanding Balance</i>
City of Salmon	\$6,662,000	\$6,145,340
City of Twin Falls	6,400,000	5,240,837
Central Shoshone County	6,000,000	531,695
City of McCall	5,908,755	5,164,598
City of Preston	5,380,000	3,765,415
City of Nampa	5,000,000	0
City of Weiser	3,670,000	1,500,000
City of Jerome	3,600,000	2,054,953
City of Post Falls	3,384,233	3,146,490
Totals	<u>\$46,004,988</u>	<u>\$27,549,328</u>

The authorized loan amount includes both completed projects and projects in progress. As of June 30, 2007, principal repayment on completed projects by the above agencies was \$4,311,063, and remaining amount to be disbursed on projects in construction was \$14,144,597.

NOTE #4

INTEREST RECEIVABLE

The interest rate on loans ranges from 0% to 4%, and loans are generally repaid over 20 years starting within one year after the project is completed. Details of loan interest receivable as of June 30, 2007, are as follows:

Interest Receivable by Category

Completed Projects	\$170,665
Projects in Progress	<u>439,667</u>
Total Interest Receivable	<u>\$610,332</u>

NOTE #5

CONTINGENCIES

The DWSRF is exposed to various risks of loss related to torts, thefts of assets, errors or omissions, or injuries to State employees while performing DWSRF business. The DWSRF maintains insurance (through the Idaho State Department of Administration, Bureau of Risk Management) for all risks of loss. The cost of insurance is included in the indirect costs charged to the DWSRF. There have not been any claims against the DWSRF since its inception in 1997.

NOTE #6**CONTRIBUTED CAPITAL AND
FUND BALANCE**

The DWSRF is capitalized by EPA grants authorized by the Act and matching funds from the State. All funds drawn are recorded as contributed capital from the EPA and the State. As of June 30, 2007, EPA has awarded capitalization grants of \$65,699,237 to the State, of which \$41,435,702 has been drawn for loans and administration of the DWSRF. The State has provided matching funds of \$10,268,474. The following schedule summarizes the capitalization grants awarded by federal fiscal year, amounts drawn on each grant as of the balance sheet date, and balances available:

<i>Year</i>	<i>EPA Grant Amount</i>	<i>Total Draws at June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws at June 30, 2007</i>	<i>Balance at June 30, 2007</i>
1997	\$12,317,286	\$12,317,286	\$0	\$12,317,286	\$0
1998	6,223,873	6,223,873	0	6,223,873	0
1999	5,971,040	5,971,040	0	5,971,040	0
2000	5,662,610	5,662,610	0	5,662,610	0
2001	5,686,043	1,326,532	4,359,511	5,686,043	0
2002	5,878,325	322,100	4,866,827	5,188,927	689,398
2003	5,842,993	85,405	234,759	320,164	5,522,829
2004	6,061,263	0	65,759	65,759	5,995,504
2005	6,048,415	0	0	0	6,048,415
2006	<u>6,007,389</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>6,007,389</u>
Totals	<u>\$65,699,237</u>	<u>\$31,908,846</u>	<u>\$9,526,856</u>	<u>\$41,435,702</u>	<u>\$24,263,535</u>

As of June 30, 2006 and 2007, the State match contributions were:

	<i>Total Match Provided at June 30, 2006</i>	<i>State Match Provided in SFY 2007</i>	<i>Total Match Provided at June 30, 2007</i>	<i>Available State Match Balance at June 30, 2007</i>
Idaho DWSRF	\$7,594,173	\$2,674,301	\$10,268,474	\$6,764,226

The available State match balance of \$6.7 million is funding that has been set aside to meet future State match requirements on the grant.

NOTE #7***EPA CAPITALIZATION GRANT***

The capitalization grants authorized under Section 1452 of the Safe Drinking Water Act are generally divided between two purposes: part of each capitalization is deposited into the DWSRF for providing loans for drinking water infrastructure projects; the other part is to be deposited into a set-aside account for other programs and activities that do not receive assistance from the Fund. In accordance with program objectives, of these set-aside activities, only the DWSRF Administration set-aside is included in the financial statements. The following schedules are intended to allow the reader to view the separate parts and total usage of the EPA capitalization grant.

Please note that the EPA reduced the 2007 grant award by \$39,500 due to a funding shortfall. The reduction was made after Set Aside budgets had been set and the EPA opted to take the full amount of the funding shortfall from loan programs as opposed to proportionately from each program. As a result, the 2007 Set Aside budgets are in excess of federal program limits. The EPA regional office is aware of this issue and has accepted the variance as presented.

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
DWSRF Administration					
1997	\$566,312	\$566,312	\$0	\$566,312	\$0
1998	284,852	284,852	0	284,852	0
1999	298,552	298,552	0	298,552	0
2000	310,280	310,280	0	310,280	0
2001	311,564	311,564	0	311,564	0
2002	322,100	322,100	0	322,100	0
2003	320,164	85,405	234,759	320,164	0
2004	332,124	0	65,759	65,759	266,365
2005	331,420	0	0	0	331,420
2006	330,752	0	0	0	330,752
Totals	<u>\$3,408,120</u>	<u>\$2,179,065</u>	<u>\$300,518</u>	<u>\$2,479,583</u>	<u>\$928,537</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
Technical Assistance					
1997	\$283,156	\$283,156	\$0	\$283,156	\$0
1998	78,584	78,584	0	78,584	0
2000	155,140	155,140	0	155,140	0
2001	155,782	155,782	0	155,782	0
2002	161,050	161,050	0	161,050	0
2003	160,082	160,082	0	160,082	0
2004	166,062	166,062	0	166,062	0
2005	165,710	0	165,710	165,710	0
2006	<u>165,376</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>165,376</u>
Totals	<u>\$1,490,942</u>	<u>\$1,159,856</u>	<u>\$165,710</u>	<u>\$1,325,566</u>	<u>\$165,376</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
Assistance: Local 1997 = Source Water Assessment, 1998-2006 = Wellhead Protection					
1997	\$1,415,780	\$1,415,780	\$0	\$1,415,780	\$0
1998	712,130	712,130	0	712,130	0
1999	746,380	746,380	0	746,380	0
2000	775,700	775,700	0	775,700	0
2001	778,910	778,910	0	778,910	0
2002	805,250	805,250	0	805,250	0
2003	800,410	800,410	0	800,410	0
2004	830,310	391,782	438,528	830,310	0
2005	828,550	0	132,944	132,944	695,606
2006	<u>826,880</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>826,880</u>
Totals	<u>\$8,520,300</u>	<u>\$6,426,342</u>	<u>\$571,472</u>	<u>\$6,997,814</u>	<u>\$1,522,486</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
Operator Certification					
1997	\$141,578	\$141,578	\$0	\$141,578	\$0
1998	106,713	106,713	0	106,713	0
1999	74,638	74,638	0	74,638	0
2000	77,570	77,570	0	77,570	0
2001	77,891	77,891	0	77,891	0
2002	80,525	80,525	0	80,525	0
2003	0	0	0	0	0
2004	41,515	41,515	0	41,515	0
2005	41,428	11,723	29,705	41,428	0
2006	<u>41,344</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>41,344</u>
Totals	<u>\$683,202</u>	<u>\$612,153</u>	<u>\$29,705</u>	<u>\$641,858</u>	<u>\$41,344</u>

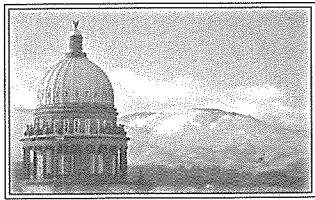
<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
PWSS: DWIMS - SDWIS					
1999	\$671,742	\$671,742	\$0	\$671,742	\$0
2000	698,130	698,130	0	698,130	0
2001	701,019	701,019	0	701,019	0
2002	724,725	724,725	0	724,725	0
2003	800,410	760,390	40,020	800,410	0
2004	788,795	517,373	271,422	788,795	0
2005	787,122	0	218,094	218,094	569,028
2006	<u>785,536</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>785,536</u>
Totals	<u>\$5,957,479</u>	<u>\$4,073,379</u>	<u>\$529,536</u>	<u>\$4,602,915</u>	<u>\$1,354,564</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
Capacity Development					
2000	\$387,850	\$387,850	\$0	\$387,850	\$0
2001	389,455	389,455	0	389,455	0
2002	402,625	223,422	179,203	402,625	0
2003	400,205	400,205	0	400,205	0
2004	415,155	321,089	88,858	409,947	5,208
2005	414,275	0	76,231	76,231	338,044
2006	<u>413,440</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>413,444</u>
Totals	<u>\$2,823,005</u>	<u>\$1,722,021</u>	<u>\$344,292</u>	<u>\$2,066,313</u>	<u>\$756,692</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
Total Set - Asides					
1997	\$2,406,826	\$2,406,826	\$0	\$2,406,826	\$0
1998	1,182,279	1,182,279	0	1,182,279	0
1999	1,791,312	1,791,312	0	1,791,312	0
2000	2,404,670	2,404,670	0	2,404,670	0
2001	2,414,621	2,414,621	0	2,414,621	0
2002	2,496,275	2,317,072	179,203	2,496,275	0
2003	2,481,271	2,206,492	274,779	2,481,271	0
2004	2,573,961	1,437,821	864,567	2,302,388	271,573
2005	2,568,505	11,723	622,684	634,407	1,934,098
2006	<u>2,563,328</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>2,563,328</u>
Totals	<u>\$22,883,048</u>	<u>\$16,172,816</u>	<u>\$1,941,233</u>	<u>\$18,114,049</u>	<u>\$4,768,999</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
DWSRF Loans (1999 Amended on 7/24/01: Decrease of \$381,342)					
1997	\$11,750,974	\$11,750,974	\$0	\$11,750,974	\$0
1998	5,939,021	5,939,021	0	5,939,021	0
1999	5,672,488	5,672,488	0	5,672,488	0
2000	5,352,330	5,352,330	0	5,352,330	0
2001	5,374,479	1,014,968	4,359,511	5,374,479	0
2002	5,556,225	0	4,866,827	4,866,827	689,398
2003	5,522,829	0	0	0	5,522,829
2004	5,729,139	0	0	0	5,729,139
2005	5,716,995	0	0	0	5,716,995
2006	<u>5,665,972</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>5,665,972</u>
Totals	<u>\$62,280,452</u>	<u>\$29,729,781</u>	<u>\$9,226,338</u>	<u>\$38,956,119</u>	<u>\$23,324,333</u>

<i>Year</i>	<i>Grant Amount</i>	<i>Total Draws June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws June 30, 2007</i>	<i>Balance at June 30, 2007</i>
Total DWSRF Capitalization Grant					
1997	\$14,157,800	\$14,157,800	\$0	\$14,157,800	\$0
1998	7,121,300	7,121,300	0	7,121,300	0
1999	7,463,800	7,463,800	0	7,463,800	0
2000	7,757,000	7,757,000	0	7,757,000	0
2001	7,789,100	3,429,589	4,359,511	7,789,100	0
2002	8,052,500	2,317,072	5,046,030	7,363,102	689,398
2003	8,004,100	2,206,492	274,779	2,481,271	5,522,829
2004	8,303,100	1,437,821	864,567	2,302,388	6,000,712
2005	8,285,500	11,723	622,684	634,407	7,651,093
2006	<u>8,229,300</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>8,229,300</u>
Totals	<u>\$85,163,500</u>	<u>\$45,902,597</u>	<u>\$11,167,571</u>	<u>\$57,070,168</u>	<u>\$28,093,332</u>



Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz
Director

December 14, 2007

Independent Auditor's Report on Internal Control
Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial
Statements Performed in Accordance
With Government Auditing Standards

Toni Hardesty, Director
Idaho Department of Environmental Quality
1410 North Hilton Street
Boise, ID 83706

Dear Ms. Hardesty:

We have audited the financial statements of the Idaho Department of Environmental Quality, Drinking Water State Revolving Fund's (DWSRF) as of and for the year ended June 30, 2007, and have issued our report thereon dated December 14, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the DWSRF's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Mike Nugent, Manager
Research & Legislation

Cathy Holland-Smith, Manager
Budget & Policy Analysis

Don H. Berg, Manager
Legislative Audits

Glenn Harris, Manager
Information Technology

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Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section, and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

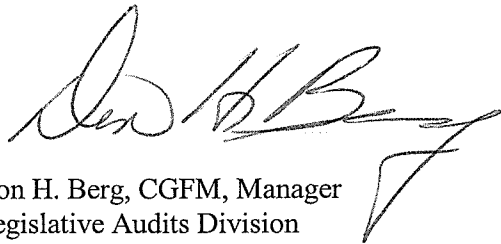
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the DWSRF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to the management of the DWSRF in a separate letter.

This report is intended solely for the information and use of the Idaho Department of Environmental Quality and the Idaho Legislature and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in dark ink, appearing to read "Don H. Berg", with a stylized flourish extending from the end of the signature.

Don H. Berg, CGFM, Manager
Legislative Audits Division

APPENDIX

HISTORY AND STATUTORY AUTHORITY

The Idaho Drinking Water State Revolving Fund (DWSRF) was established pursuant to the Federal Safe Drinking Water Act of 1996. The DWSRF has been capitalized by a series of grants from the U.S. Environmental Protection Agency beginning in 1997.

PURPOSE

The Act established the DWSRF to assist public water systems with financing the costs of the infrastructure needed to achieve or maintain compliance with Act requirements and to protect public health. Section 1452 of the Act authorizes the administrator of the EPA to award capitalization grants to states, which in turn can provide low-cost loans and other forms of assistance to eligible systems. The Act also establishes a strong emphasis on preventing contamination and enhancing water system management by allowing states to use some of the funds for source water protection, capacity development, and operator certification. These other activities are known as grant "set-asides." All DWSRF loan repayments, including interest and principal, must be returned to the DWSRF. DWSRF resources are to be used for eligible purposes in perpetuity. In accordance with the Act, the corpus of the federal and State capital contributions to the DWSRF will be maintained. All DWSRF loan disbursement, repayment, deposit of EPA contribution, deposit of State match, and related transactions are accounted for separately in the DWSRF.

ORGANIZATION AND STAFFING

The DWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The DWSRF has no full-time employees, but instead uses DEQ employees on a part-time basis. The part-time positions include the DWSRF's bureau chief, senior accountant, loan program specialist, water quality analyst, four regional managers, and several staff and technical engineers.

Department of Environmental Quality
Organizational Structure

